

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.  
D/B/A WESTVIEW HOSPITAL AND AFFILIATED  
ENTITIES**

**BOARD OF DIRECTORS MEETING**

**APRIL 18, 2008**

*CPAs / ADVISORS*



**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.  
d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

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FINANCIAL STATEMENTS

BENCHMARKING

BOARD OF DIRECTOR LETTER



**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.  
d/b/a WESTVIEW HOSPITAL AND AFFILIATED  
ENTITIES**

**COMBINED FINANCIAL STATEMENTS**

**AND**

**SUPPLEMENTARY INFORMATION**

**AUGUST 31, 2007 AND 2006**

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

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## REPORT OF INDEPENDENT AUDITORS

Board of Directors  
Indianapolis Osteopathic Hospital, Inc.  
d/b/a Westview Hospital and Affiliated Entities  
Indianapolis, Indiana

We have audited the accompanying combined balance sheets of Indianapolis Osteopathic Hospital, Inc. d/b/a Westview Hospital and Affiliated Entities (the Organization) as of August 31, 2007 and 2006, and the related combined statements of operations and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of August 31, 2007 and 2006, and the combined results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the combined financial statements. This information has been subjected to the auditing procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole.

*Blue & Co., LLC*

March 6, 2008

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

COMBINED BALANCE SHEETS  
AUGUST 31, 2007 AND 2006

<b>ASSETS</b>		
	<u>2007</u>	<u>2006</u>
<b>Current assets</b>		
Cash and cash equivalents	\$ 901,554	\$ 1,069,023
Patient accounts receivable, less allowance for estimated uncollectible amounts of \$2,150,270 in 2007 and \$1,599,256 in 2006	4,251,203	4,981,773
Other receivables	132,617	433,406
Inventories	453,597	237,757
Prepaid expenses and other current assets	264,427	352,300
Estimated third-party settlements	312,173	-0-
Total current assets	6,315,571	7,074,259
<b>Assets limited as to use</b>		
Internally designated for capital acquisitions	8,268,820	8,072,646
<b>Property and equipment</b>		
Land and improvements	1,182,678	1,182,678
Buildings and improvements	34,783,778	34,293,945
Equipment	23,786,774	22,523,702
	59,753,230	58,000,325
Less accumulated depreciation	33,050,706	30,245,216
	26,702,524	27,755,109
Construction in progress	280,315	91,112
Total property and equipment, net	26,982,839	27,846,221
<b>Interest in net assets of Foundation</b>	458,722	434,084
<b>Other assets</b>		
Derivative asset	57,199	-0-
Investment in affiliates	50,000	-0-
Physician recruitment	120,000	240,000
Other	818,773	690,529
Total other assets	1,045,972	930,529
Total assets	<u>\$ 43,071,924</u>	<u>\$ 44,357,739</u>

See accompanying notes to combined financial statements.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

COMBINED BALANCE SHEETS  
AUGUST 31, 2007 AND 2006

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**LIABILITIES AND NET ASSETS**

	<u>2007</u>	<u>2006</u>
<b>Current liabilities</b>		
Current portion of long-term debt	\$ 1,308,735	\$ 1,338,282
Accounts payable	2,601,441	1,765,941
Accrued salaries and related liabilities	1,641,806	1,641,439
Accrued property taxes	124,937	124,937
Accrued interest	41,299	37,215
Estimated third-party settlements	-0-	208,477
Total current liabilities	<u>5,718,218</u>	<u>5,116,291</u>
<b>Long-term liabilities</b>		
Long-term debt, less current portion	10,946,416	11,900,323
Physician recruitment	120,000	240,000
Total long-term liabilities	<u>11,066,416</u>	<u>12,140,323</u>
Total liabilities	16,784,634	17,256,614
<b>Net assets</b>		
Unrestricted	25,828,568	26,667,041
Temporarily restricted	458,722	434,084
Total net assets	<u>26,287,290</u>	<u>27,101,125</u>
Total liabilities and net assets	<u><u>\$ 43,071,924</u></u>	<u><u>\$ 44,357,739</u></u>

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See accompanying notes to combined financial statements.



**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

COMBINED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS  
YEARS ENDED AUGUST 31, 2007 AND 2006

	2007	2006
<b>Revenues, gains and other support</b>		
Net patient service revenue	\$ 42,187,874	\$ 39,520,679
Membership fees and ancillary income	4,521,833	4,665,725
Rental revenue	309,015	269,727
Other revenue	1,097,919	1,337,011
Net assets released from restriction	24,638	95,970
Total revenues, gains and other support	48,141,279	45,889,112
<b>Expenses</b>		
Salaries and wages	20,299,351	19,103,886
Employee benefits	4,372,014	4,641,920
Purchased services	6,773,679	6,442,265
Supplies	5,047,621	4,042,216
Utilities	1,344,773	1,190,061
Insurance	727,972	785,951
Interest	633,667	615,593
Equipment lease and rental	365,853	273,644
Depreciation and amortization	3,271,990	3,237,897
Property tax expense (refunds)	114,674	(310,878)
Bad debts	3,369,423	2,533,914
Other	2,839,312	2,448,548
Total expenses	49,160,329	45,005,017
Operating income (loss)	(1,019,050)	884,095
<b>Other changes in unrestricted net assets</b>		
Unrealized gain on derivative	57,199	-0-
Unrealized gain (loss) on investments	123,378	(302,372)
Change in unrestricted net assets	(838,473)	581,723
<b>Changes in temporarily restricted net assets</b>		
Change in interest in net assets of Foundation	24,638	6,997
Change in net assets	(813,835)	588,720
<b>Net assets</b>		
Beginning of year	27,101,125	26,512,405
End of year	\$ 26,287,290	\$ 27,101,125

See accompanying notes to combined financial statements.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

COMBINED STATEMENTS OF CASH FLOWS  
YEARS ENDED AUGUST 31, 2007 AND 2006

	2007	2006
<b>Operating activities</b>		
Change in net assets	\$ (813,835)	\$ 588,720
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Change in interest in net assets of Foundation	(24,638)	(6,997)
Depreciation and amortization	3,271,990	3,237,897
Bad debts	3,369,423	2,533,914
Net unrealized (gain) loss on investments	(123,378)	302,372
Unrealized gain on derivative	(57,199)	-0-
Changes in operating assets and liabilities		
Patient accounts receivable	(2,638,853)	(2,833,754)
Other receivables	300,789	(467,612)
Inventories	(215,840)	17,742
Prepays and other current assets	87,873	(665,573)
Accounts payable	835,500	528,037
Accrued salaries and related liabilities	367	(375,427)
Accrued property taxes	-0-	(153,981)
Other long-term liabilities	-0-	(340,948)
Accrued interest	4,084	(4,389)
Estimated third-party settlements	(520,650)	(456,084)
Net cash flows from operating activities	3,475,633	1,903,917
<b>Investing activities</b>		
Acquisition and construction of capital assets	(1,682,767)	(4,014,331)
Change in funds held by Trustee, net	-0-	2,043,807
Other changes in internally designated for capital acquisitions	(72,796)	1,470,496
Change in investment in affiliate	(50,000)	-0-
Other changes in other assets	(594,744)	2,551
Net cash flows from investing activities	(2,400,307)	(497,477)
<b>Financing activities</b>		
Repayment of long-term debt	(1,242,795)	(1,289,449)
Net change in cash and cash equivalents	(167,469)	116,991
<b>Cash and cash equivalents</b>		
Beginning of year	1,069,023	952,032
End of year	<u>\$ 901,554</u>	<u>\$ 1,069,023</u>
<b>Noncash investing and financing transaction</b>		
Capital lease obligation incurred for use of equipment	\$ 259,341	\$ 598,054
<b>Supplemental disclosure of cash flows information</b>		
Cash paid for interest	\$ 629,583	\$ 624,030

See accompanying notes to combined financial statements.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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**1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

Nature of Operations

Indianapolis Osteopathic Hospital, Inc. d/b/a Westview Hospital (the Hospital) is an Indiana not-for-profit acute care Hospital. Health Institute of Indiana, Inc. (HII) is an Indiana not-for-profit fitness center and other healthcare facility. HII is a wholly-controlled affiliate of the Hospital.

The Hospital, located in Indianapolis, Indiana, is a general acute care facility providing inpatient and outpatient services with associated ancillary departments. HII, located on the Hospital's main campus, is a fitness center providing a wide variety of health services to its membership.

The combined financial statements include the accounts of the Hospital and its wholly-controlled affiliated entity, HII (collectively called the Organization). All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of the combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including the allowance for estimated uncollectible accounts and estimated third-party settlements, and disclosure of contingent assets and liabilities at the date of the combined financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period and could differ from actual results.

Cash and Cash Equivalents

For the purposes of reporting cash flows, cash and cash equivalents include all cash held in checking and money market accounts available for operating purposes with original maturities of 90 days or less. The Organization maintains these deposits with banks which, at times may exceed federally insured limits. The Organization has not experienced any loss in these accounts. The Organization believes it is not exposed to any significant credit risk on cash and cash equivalents.

Investments and Investment Income

Investments in equity securities and debt securities are measured at fair value in the balance sheets. Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
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**NOTES TO COMBINED FINANCIAL STATEMENTS**  
**AUGUST 31, 2007 AND 2006**

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Investment income (including realized gains and losses on investments, interest, dividends and declines in value determined to be other-than-temporary) from all investments is reported as gains (losses) unless the income is restricted by donor or law. Unrealized gains (losses) on investments that are considered temporary are excluded from net income due to the non-trading nature of the investments.

Assets Limited as to Use

Assets whose use is limited include funds designated by the Board of Directors for future replacement of property and equipment, over which the Board retains control and may at its discretion subsequently use for other purposes. A portion of the internally designated funds include investments in debt and equity securities. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value on the balance sheet at August 31, 2007 and 2006. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law.

Property and Equipment and Depreciation

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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Operating Indicator

The combined statements of operations and changes in net assets include an operating indicator. Changes in unrestricted net assets which are excluded from the operating indicator, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Net Patient Service Revenue

The Organization is a provider of services to patients entitled to coverage under Titles XVIII and XIX of the Health Insurance Act (Medicare and Medicaid). The Organization is reimbursed for Medicare and Medicaid inpatient services based on a fixed price per discharge for each diagnosis related grouping (DRG). The Organization is reimbursed for Medicare and Medicaid outpatient services based on a fixed price per clinical unit of service. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Organization's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients.

Net patient service revenue is reported as the estimated realizable amounts from patients, third-party payors, and others for services provided and includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Revenue under certain third-party payor agreements is subject to audit, retroactive adjustments, and significant regulatory actions. Provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in the future periods as additional information becomes available and as final settlements are determined. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates will change by a material amount in the near term.

During 2007 and 2006, approximately 38% and 36% of the Hospital's net patient service revenue, respectively, was received under the Medicare program, while approximately 4% and 3% of net service revenue, respectively, was received under the State Medicaid program.

The provision for bad debts is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in healthcare coverage and other collection indicators. Management assesses the adequacy of allowance for uncollectible accounts based upon historical write off experience by payor category.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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The results of this review are then used to make any modifications to the provision for bad debts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the Hospital follows established guidelines for placing certain past due patient balances with collection agencies.

Membership Fees

HII received revenue from membership dues for the fitness center and related ancillary services.

Charity Care

The Organization provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital and WDS are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying combined financial statements. No donor-restricted contributions currently exist.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Organization has been limited by external sources for a specific time period or purpose. When a restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions. Restrictions that are met within the year of receipt are reflected with unrestricted net assets. As of August 31, 2007 and 2006, temporarily restricted net assets were \$458,722 and \$434,084, respectively. The temporarily restricted net assets relate to the Organization's interest in the net assets of the Foundation.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
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NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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Income Taxes

The Hospital and HII are not-for-profit corporations and have been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code.

During 2006, HII was granted relief from property taxes on a portion of its facilities. A refund was received for prior assessments and is recorded in the combined statements of operations and changes in net assets.

Advertising Costs

The Hospital's policy is to expense advertising costs when the advertising first takes place. Advertising expenses were \$358,671 and \$352,103 in 2007 and 2006, respectively.

Inventories

Inventories are determined by physical count, are priced at cost, (first-in, first-out method) and are not in excess of market value.

Unamortized Financing Costs

Costs incurred in connection with obtaining long-term debt have been deferred. These costs are amortized over the period the obligations are outstanding using a method approximating the effective interest method. These amounts are included in other assets.

Derivative Financial Instruments

The Organization uses derivative financial instruments (cash flow hedge interest rate swap agreement) to manage its exposure to fluctuations in interest rates. All derivatives are recorded as either assets or liabilities in the combined balance sheets, and periodically adjusted to fair value. The classification of gains and losses resulting from changes in the fair values of derivatives is dependent on the intended use of the derivative and its resulting designation. Adjustments to reflect changes in fair values of derivatives that are not considered highly effective hedges are reflected in earnings. Adjustments to reflect changes in fair values of derivatives that are considered highly effective hedges are either reflected in earnings and largely offset by corresponding adjustments related to the fair value of the hedged items, or reflected in other comprehensive income until the hedged transaction matures and the entire transaction is recognized in earnings. The change in fair value of the ineffective portion of a hedge is immediately recognized in earnings.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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For the years ended August 31, 2007 and 2006, the Organization recognized a derivative asset of \$57,199 and \$-0-, respectively. The Organization recognized an unrealized gain of \$57,199 and \$-0- in 2007 and 2006, respectively.

Accounting Pronouncement

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners" ("FIN 45-3"). It served as an amendment to FASB Interpretation No. 45, "Guarantor's Accounting of Indebtedness of Others" ("FIN 45") by adding minimum revenue guarantees to the list of examples of contracts to which FIN 45 applies. FIN 45 is effective for new minimum revenue guarantees issued or modified on or after January 1, 2006.

The Organization adopted this amendment to FIN 45 effective January 1, 2006. For periods ending before January 1, 2006, the Hospital did not report the fair value of its obligations under physician revenue guarantee agreements. However, under FIN 45 as amended, the Hospital is required to report the liability for these physician revenue guarantees on its balance sheets at fair value and amortize the related prepaid physician recruitment expense over the period of the physician's contractual commitment to practice in the local community, which is typically three years. The Hospital recognized an asset and corresponding liability \$120,000 and \$240,000 as of August 31, 2007 and 2006, respectively.

Reclassifications

Certain amounts from 2006 have been reclassified in order to conform to the current year presentation.



**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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**2. INVESTMENTS**

The composition of assets limited as to use at August 31, 2007 and 2006 is set forth in the following table. Investments are stated at fair value.

	2007	2006
Internally designated for capital acquisitions		
Cash and cash equivalents	\$ 376,685	\$ 472,901
Taxable bonds	3,222,005	3,057,203
Equities	4,670,130	4,542,542
	<u>\$ 8,268,820</u>	<u>\$ 8,072,646</u>

**3. INTEREST IN NET ASSETS OF FOUNDATION**

The Westview Medical Foundation, Inc. (the Foundation), which is a financially interrelated organization with Westview Hospital, was established to solicit contributions from the general public and to support the Hospital activities. Funds are distributed to the Hospital as determined by the Foundation's Board of Trustees. A summary of the Foundation assets, liabilities, net assets, results of operations and changes in net assets for August 31, 2007 and 2006, follows. The Hospital's interest in the net assets of the Foundation is reported as a non-current asset in the balance sheets.

	2007	2006
<b>Financial position</b>		
Assets, principally cash, investments and property	<u>\$ 458,722</u>	<u>\$ 434,084</u>
Liabilities	\$ -0-	\$ -0-
Net assets	458,722	434,084
Total liabilities and net assets	<u>\$ 458,722</u>	<u>\$ 434,084</u>
<b>Statement of activities</b>		
Support, revenue and income	\$ 234,035	\$ 149,804
Expenses		
Contributions to Westview Hospital	103,283	95,970
Other	106,114	46,837
Total expenses	<u>209,397</u>	<u>142,807</u>
Change in net assets	<u>\$ 24,638</u>	<u>\$ 6,997</u>

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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**4. DEFERRED COMPENSATION**

In October 2004, the Organization entered into a Deferred Compensation Agreement. Under the agreement, compensation and certain benefits will be paid through October 2007. This amount is \$99,624 and \$336,505 as of August 31, 2007 and 2006, respectively. The accrual is included in salaries and related liabilities on the combined balance sheets. This agreement specifies that if certain events happen the salary and benefits payable by Westview Hospital will be reduced accordingly.

In August 2005, the Organization entered into another Deferred Compensation Agreement. Under this agreement, compensation and certain benefits were paid through November 2006. This amount approximated \$-0- and \$34,194 as of August 31, 2007 and 2006, respectively. The accrual was included in salaries and related liabilities on the combined balance sheets.

**5. LONG-TERM DEBT AND CAPITAL LEASES**

A summary of long-term debt and capital lease obligations as of August 31, 2007 and 2006 follows:

	<u>2007</u>	<u>2006</u>
Hospital Authority of Marion County, Indiana		
Adjustable Rate Demand Hospital Revenue Bonds of 2004. Bonds payable from August 2005 through November 2019. Variable interest rate at August 31, 2007 was 3.53%. An interest rate swap was entered into for \$8,500,000 of the bonds. Fixed rate on this portion is 3.42%.	\$ 11,595,000	\$ 12,670,000
Capital lease obligations, at varying rates of imputed interest from 5 percent to 8 percent collateralized by leased equipment	<u>660,151</u> 12,255,151	<u>568,605</u> 13,238,605
Less current portion	<u>1,308,735</u>	<u>1,338,282</u>
Long-term debt, net of current portion	<u>\$ 10,946,416</u>	<u>\$ 11,900,323</u>

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
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Variable Rate Loan Program Notes

The 2004 bonds are secured by the Hospital with a general security agreement pledging the Hospital's assets and an irrevocable letter of credit issued by a bank. The termination date of the letter of credit is November 15, 2009. The 2004 bonds are secondarily guaranteed by HII. The letter of credit requires compliance with specific financial covenants. The Organization was out of compliance as of August 31, 2007. A waiver for the covenant violation was granted by the bank.

While the 2004 bonds bear interest in one of the Interest Rate Modes other than the fixed interest rate, the interest rate for a particular interest rate period is determined by the remarketing agent on the Interest rate determination date. Such interest rate is effective on the Interest Rate Adjustment Date for the succeeding Interest Rate Period. Various redemption dates and redemption prices exist.

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows:

Year Ending August 31,	Long-term debt	Capital lease obligations
2008	\$ 1,120,000	\$ 228,458
2009	1,175,000	228,458
2010	1,242,500	176,764
2011	1,297,500	138,296
2012	830,000	5,257
Thereafter	5,930,000	-0-
	\$ 11,595,000	777,233
Less amount representing interest under capital lease obligations		117,082
		\$ 660,151

Effective June 2, 2005, the Hospital entered into a 10-year "cash flow hedge interest rate swap" agreement for \$8,500,000. Under his agreement, the Hospital pays a fixed rate of 3.418% and receives the USD-BMA Municipal Swap Index as a hedge against the note. The swap agreement had an original notional amount of \$8,500,000 with accreting and amortization in accordance with the swap agreement. The Organization recorded a derivative asset of \$57,199 and \$-0- as of August 31, 2007 and 2006, respectively. The Organization recognized an unrealized gain of \$57,199 and \$-0- in 2007 and 2006, respectively

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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The following is an analysis of the leased assets included in property and equipment as of August 31:

	2007	2006
Equipment	\$ 857,395	\$ 598,054
Less accumulated depreciation	178,733	51,734
	<u>\$ 678,662</u>	<u>\$ 546,320</u>

Amortization of capital leases is included in depreciation on the combined statements of operations and changes in net assets.

## 6. MEDICAL MALPRACTICE CLAIMS

The State of Indiana puts a judgment cap of \$1,250,000 on malpractice claims for those institutions and individual physicians willing to participate in the state funded insurance "pool". The "pool" requires that an institution/physician be responsible for the first \$250,000 of every claim and the state will fund the remaining balance of each claim. Malpractice claims related to the period that the Hospital was insured by PHICO Insurance Company are being defended by the Indiana Guaranty Fund. To the extent these claims exceed the statutory claim limits set for Guaranty Fund claims, the Hospital may have exposure to the applicable limit for a Qualified Provider during the relevant claim period. Further, the Hospital may have exposure to one claim that is not covered by insurance.

On July 1, 2006, the Organization became a member in a captive insurance company, Suburban Health Organization Segregated Portfolio Company, LLC, to fund the Organization's required portion of the professional and physician insurance coverage pursuant to the Act as well as its general liability insurance and excess coverage. The Organization made an initial capital investment of \$50,000 for 20% ownership in the captive which is included in investments in affiliates. The investment is accounted for under the equity method. The captive provides protection from liability in an amount not to exceed \$250,000 per incident and aggregate liability protection not to exceed \$7,500,000 per year. In addition, the Organization maintains a commercial umbrella/excess liability policy with a limit of \$1,000,000 each occurrence, \$1,000,000 fire legal liability, \$1,000,000 personal and advertising injury, and a \$3,000,000 total policy aggregate. Premiums are accrued based on the captive's experience.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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No accrual for possible losses attributable to incidents that may have occurred but that have not been identified has been made because the amount, if any, is not reasonably estimable. The current policy is on a claims-made basis and as long as this coverage is continued or replaced with equivalent insurance, claims based on occurrences during its term but reported subsequently will be insured.

## 7. RETIREMENT PLAN

The Hospital has a money purchase pension plan to cover all employees having more than one year of service at the Hospital who are at least 21 years of age. The plan is funded at the rate of 7% of each eligible employee's compensation not in excess of the taxable wage base and 12% for amounts over the taxable wage base. The taxable wage base is the contribution and benefits base under Section 230 of the Social Security Act. Vesting in the plan occurs over a period of seven years. Termination of employees resulted in forfeitures which reduces the plan liability. The Hospital contributions to the plan of \$792,696 and \$731,789 for 2007 and 2006, respectively, have been included in employee benefits in the combined statements of operations and changes in net assets.

## 8. CONCENTRATIONS OF CREDIT RISK

The Organization's main office is located in Indianapolis, Indiana. The Organization grants credit without collateral to its patients, most of whom are local residents are insured under third-party payor agreements. Accounts receivable from patients and third-party payors were as follows:

	<u>2007</u>	<u>2006</u>
Medicare and Medicaid	43%	46%
Blue Cross	16%	9%
Other (none over 10%)	20%	21%
Self-Pay	21%	24%
	<u>100%</u>	<u>100%</u>

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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**9. COMMITMENTS AND CONTINGENCIES**

Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. These leases expire in various years through 2011. Rental expense was \$365,853 and \$273,644 for 2007 and 2006, respectively. Minimum future rental payments under non-cancelable operating leases for each of the next 5 years are:

Year Ending August 31,	
2008	\$ 203,536
2009	181,103
2010	181,103
2011	123,082
2012	43,792
	<u>\$ 732,616</u>

Litigation

The Organization is involved in litigation arising in the course of business. After consultation with legal counsel, management estimates that these amounts will be resolved without material adverse effect on the Organization's future financial position or result from operations.

Purchase Commitments

As of August 31, 2007, the Organization had purchase commitments of approximately \$255,000 for property and equipment in 2008.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006

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**10. RENT INCOME**

HII leases space in its building. These leases expire in various years through January 2012 and are payable in monthly installments.

Future minimum rental income under these agreements is as follows:

Year Ending August 31,	
2008	\$ 174,686
2009	174,686
2010	152,114
2011	150,062
2012	44,596
	<u>\$ 696,144</u>

**11. FUNCTIONAL EXPENSES**

The Organization provides general healthcare and health club services to residents within its geographic location. Expenses related to providing these services are as follows 2007 and 2006:

	2007	2006
Health care services	\$ 27,507,420	\$ 24,730,530
Health club services	2,211,566	2,390,152
General and administrative	11,323,617	11,021,858
Provision for bad debt	3,369,423	2,533,914
Depreciation and amortization	3,271,990	3,237,897
Property tax expense (refunds)	114,674	(310,878)
Insurance	727,972	785,951
Interest	633,667	615,593
	<u>\$ 49,160,329</u>	<u>\$ 45,005,017</u>

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.  
d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

**NOTES TO COMBINED FINANCIAL STATEMENTS  
AUGUST 31, 2007 AND 2006**

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**12. CHARITY CARE**

The amount of charges foregone for services and supplies furnished under the Organization's charity care policy aggregated approximately \$677,419 and \$832,395 for the years ended August 31, 2007 and 2006, respectively.

**13. SELF INSURED HEALTH PLAN**

The health plan is self-insured by the Organization. A third-party claims administrator has been retained to process all benefit claims. Claims are processed and presented for payment on a bi-weekly basis. The Plan purchased individual excess risk insurance to cover individual health claims in excess of a predetermined amount. In addition, the Plan has an aggregate stop loss of a predetermined amount. Total expense for 2007 and 2006 was \$1,572,343 and \$2,083,296, respectively.

**14. MANAGEMENT'S CONSIDERATION OF GOING CONCERN**

The Organization experienced a significant operating loss during the year ended August 31, 2007, as well as diminishing cash reserves. Additionally, there has been a high level of turnover, particularly in key management positions. Management is considering several alternatives for mitigating these conditions during the next year. These include improving the timeliness of patient billing and collection of patient accounts receivables, continuing to institute programs to help increase inpatient days and outpatient procedures, and reducing certain expenditures as deemed appropriate.



## **SUPPLEMENTARY INFORMATION**

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

**COMBINING BALANCE SHEETS**  
**AUGUST 31, 2007**

	Westview Hospital	Health Institute of Indiana, Inc.	Eliminations	Total
<b>Assets</b>				
Current assets				
Cash and cash equivalents	\$ 139,951	\$ 761,603	\$ -0-	\$ 901,554
Patient accounts receivable, net	4,168,717	82,486	-0-	4,251,203
Other receivables	604,075	41,542	(513,000)	132,617
Inventories	429,754	23,843	-0-	453,597
Prepaid expenses and other current assets	204,594	59,833	-0-	264,427
Estimated third-party settlements	312,173	-0-	-0-	312,173
Total current assets	5,859,264	969,307	(513,000)	6,315,571
Assets limited as to use				
Internally designated for capital acquisitions	8,268,820	-0-	-0-	8,268,820
Property and equipment				
Land and improvements	1,182,678	-0-	-0-	1,182,678
Buildings and improvements	19,816,548	14,967,230	-0-	34,783,778
Equipment	22,169,802	1,616,972	-0-	23,786,774
	43,169,028	16,584,202	-0-	59,753,230
Less accumulated depreciation	28,391,646	4,659,060		33,050,706
	14,777,382	11,925,142	-0-	26,702,524
Construction in progress	280,315	-0-		280,315
Total property and equipment, net	15,057,697	11,925,142	-0-	26,982,839
Interest in net assets of Foundation	458,722	-0-	-0-	458,722
Other assets				
Derivative asset	57,199	-0-	-0-	57,199
Investment in affiliates	4,393,949	-0-	(4,343,949)	50,000
Related party note receivable	7,666,000	-0-	(7,666,000)	-0-
Physician recruitment	120,000	-0-	-0-	120,000
Other	807,375	11,398	-0-	818,773
Total other assets	13,044,523	11,398	(12,009,949)	1,045,972
Total assets	<u>\$ 42,689,026</u>	<u>\$ 12,905,847</u>	<u>\$ (12,522,949)</u>	<u>\$ 43,071,924</u>

See report of independent auditors on page 1.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

**COMBINING BALANCE SHEETS**  
**AUGUST 31, 2007**

	Westview Hospital	Health Institute of Indiana, Inc.	Eliminations	Combined
<b>Liabilities and net assets</b>				
Current liabilities				
Current portion of long-term debt	\$ 1,308,735	\$ 513,000	\$ (513,000)	\$ 1,308,735
Accounts payable	2,458,728	142,713	-0-	2,601,441
Accrued salaries and related liabilities	1,529,483	112,323	-0-	1,641,806
Accrued property taxes	-0-	124,937	-0-	124,937
Accrued interest	38,374	2,925	-0-	41,299
Total current liabilities	5,335,320	895,898	(513,000)	5,718,218
Long-term liabilities				
Long-term debt, less current portion	10,946,416	7,666,000	(7,666,000)	10,946,416
Physician recruitment	120,000	-0-	-0-	120,000
Total long-term liabilities	11,066,416	7,666,000	(7,666,000)	11,066,416
Total liabilities	16,401,736	8,561,898	(8,179,000)	16,784,634
Net assets				
Unrestricted	25,828,568	4,343,949	(4,343,949)	25,828,568
Temporarily restricted	458,722	-0-	-0-	458,722
Total net assets	26,287,290	4,343,949	(4,343,949)	26,287,290
Total liabilities and net assets	\$ 42,689,026	\$ 12,905,847	\$ (12,522,949)	\$ 43,071,924

See report of independent auditors on page 1.

**INDIANAPOLIS OSTEOPATHIC HOSPITAL, INC.**  
**d/b/a WESTVIEW HOSPITAL AND AFFILIATED ENTITIES**

**COMBINING STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
**YEAR ENDED AUGUST 31, 2007**

	Westview Hospital	Health Institute of Indiana, Inc.	Eliminations	Total
<b>Revenues, gains and other support</b>				
Net patient service revenue	\$ 42,187,874	\$ -0-	\$ -0-	\$ 42,187,874
Membership fees and ancillary income	-0-	4,521,833	-0-	4,521,833
Rental revenue	111,300	477,461	(279,746)	309,015
Other revenue	1,485,423	28,688	(416,192)	1,097,919
Net assets released from restriction	24,638	-0-	-0-	24,638
Total revenues, gains and other support	43,809,235	5,027,982	(695,938)	48,141,279
<b>Expenses</b>				
Salaries and wages	18,651,520	1,647,831	-0-	20,299,351
Employee benefits	4,133,938	238,076	-0-	4,372,014
Purchased services	6,518,476	255,203	-0-	6,773,679
Supplies	4,721,962	325,659	-0-	5,047,621
Utilities	855,603	489,170	-0-	1,344,773
Insurance	668,602	59,370	-0-	727,972
Interest	633,667	416,192	(416,192)	633,667
Equipment lease and rental	592,386	53,213	(279,746)	365,853
Depreciation and amortization	2,711,429	560,561	-0-	3,271,990
Property tax expense	39,600	75,074	-0-	114,674
Provision for bad debts	3,296,041	73,382	-0-	3,369,423
Other	2,370,060	469,252	-0-	2,839,312
Total expenses	45,193,284	4,662,983	(695,938)	49,160,329
Operating income (loss)	(1,384,049)	364,999	-0-	(1,019,050)
<b>Other changes in unrestricted net assets</b>				
Income in affiliates	364,999	-0-	(364,999)	-0-
Unrealized gain on derivative	57,199	-0-	-0-	57,199
Unrealized gain on investments	123,378	-0-	-0-	123,378
Change in unrestricted net assets	(838,473)	364,999	(364,999)	(838,473)
<b>Change in temporarily restricted net assets</b>				
Change in interest in net assets of Foundation	24,638	-0-	-0-	24,638
Change in net assets	(813,835)	364,999	(364,999)	(813,835)
<b>Net assets</b>				
Beginning of year	27,101,125	3,978,950	(3,978,950)	27,101,125
End of year	<u>\$ 26,287,290</u>	<u>\$ 4,343,949</u>	<u>\$ (4,343,949)</u>	<u>\$ 26,287,290</u>

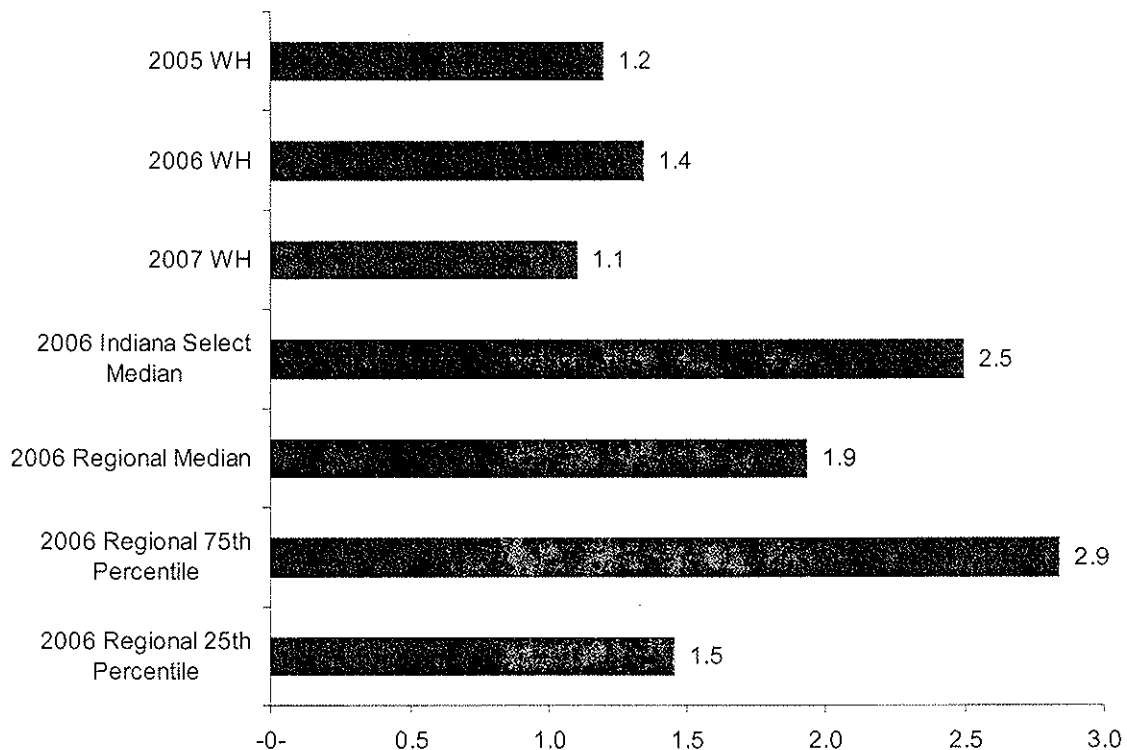
See report of independent auditors on page 1.



# Westview Hospital

## Current Ratio

CPAS - ADVISORS



Desired Position: High

US Trend: Stable

US Forecast: Stable for next five years

### Formula

Current Assets / Current Liabilities

### Definition

Measures the Hospital's ability to meet short-term financial obligations.

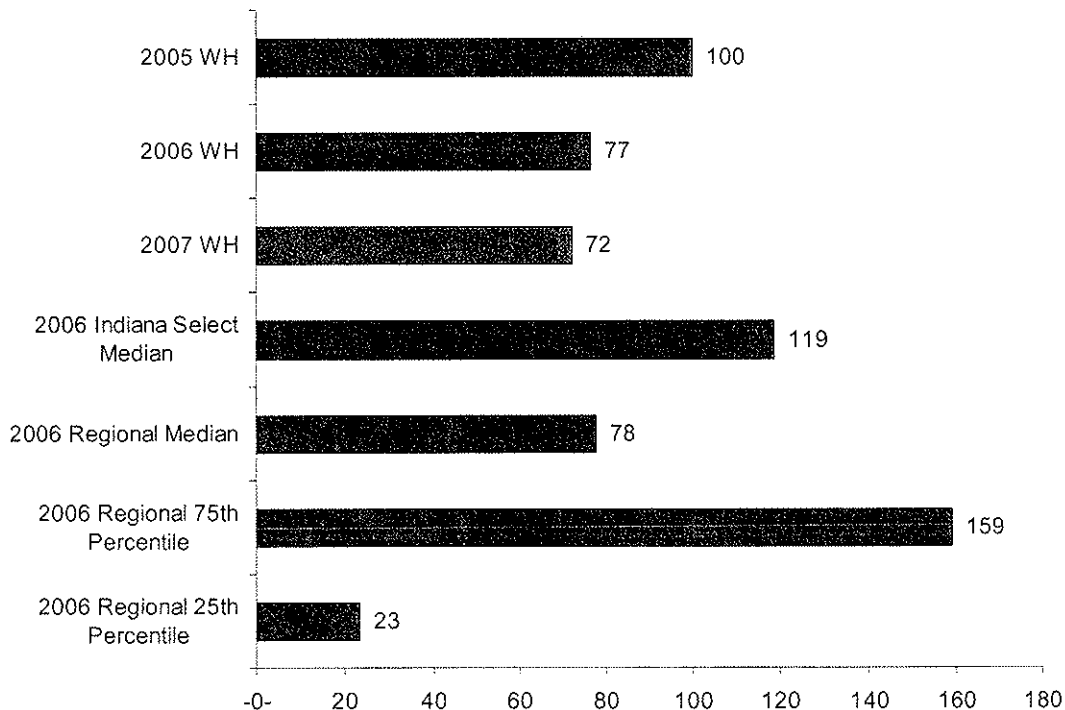
### Performance Implications

There is a positive correlation between profitability and the Current Ratio. Hospitals that are more profitable are likely to have higher Current Ratio values. It may be difficult for hospitals with a consistently low Current Ratio to continue with inadequate total margins.

# Westview Hospital

## Days Cash on Hand (All Sources)

CPAS - ADVISORS



Desired Position: High  
US Trend: Decreasing  
US Forecast: Stable

### Formula

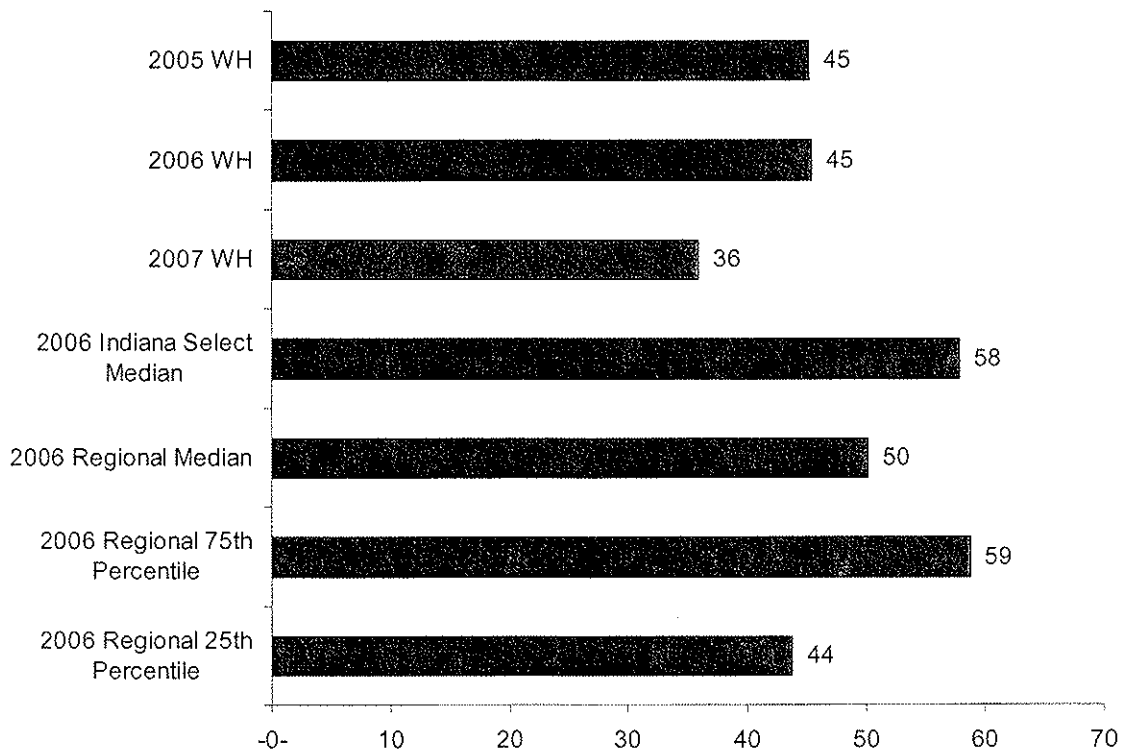
Unrestricted Current and Non-current Cash and Investments / [(Total Expenses less Depreciation and Amortization) / 365]

### Definition

Days cash on hand is a liquidity ratio that measures the number of days of cash operating expenses a hospital has covered by unrestricted cash, cash equivalents and marketable securities.

### Performance Implications

High values indicate a greater ability to meet both short-term obligations and long-term capital replacement needs. Lower performing hospitals have lower values. Improvement can come from improved cash flow from operations and financing the purchases of property and equipment.



Desired Position: Low  
 US Trend: Decreasing since 2000  
 US Forecast: Stable

### Formula

Net Accounts Receivable / (Net Patient Service Revenues / 365)

### Definition

Days in Accounts Receivable is a liquidity ratio which measures the average time that receivables are outstanding and is thus an indicator of the efficiency in collecting receivables.

### Performance Implications

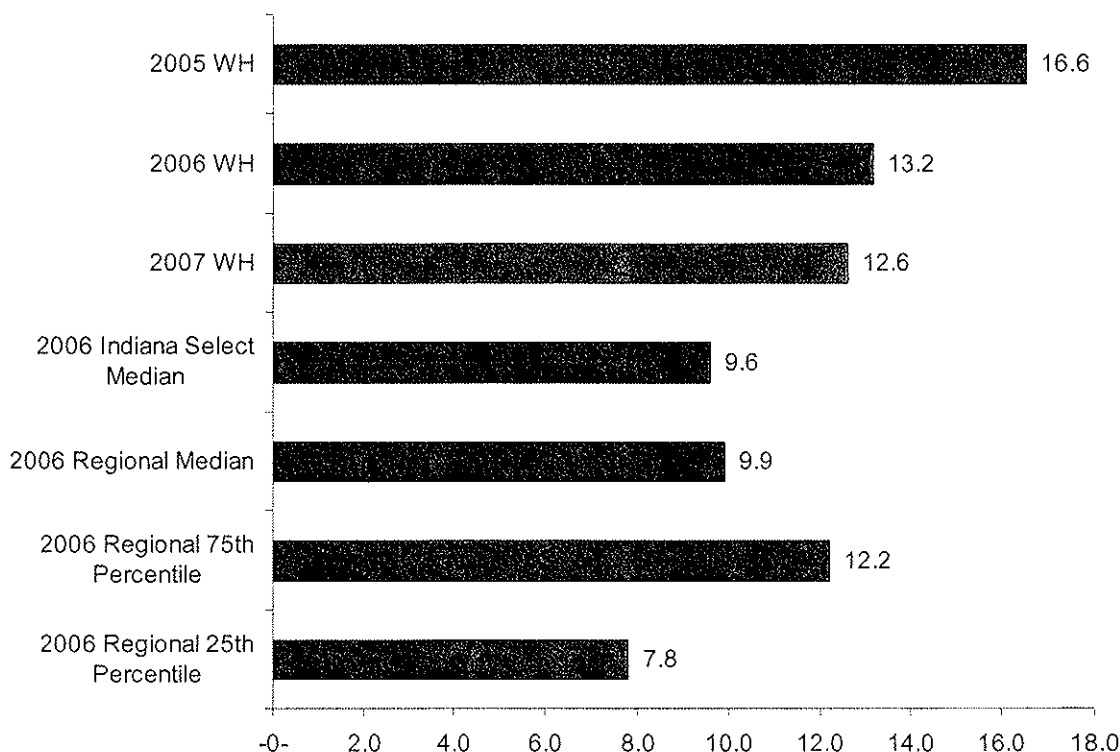
Payor mix can significantly effect the value of this ratio. Hospitals with high values have an excess investment in a non-earning asset. High-performing hospitals tend to earn higher margins and have higher values of cash and investments.



# Westview Hospital

## Average Age of Plant

CPAS - ADVISORS



Desired Position: Low  
US Trend: Decrease  
US Forecast: Increase

### Formula

Accumulated Depreciation / Depreciation Expense

### Definition

Measures the average age, in years, of a hospital's fixed assets.

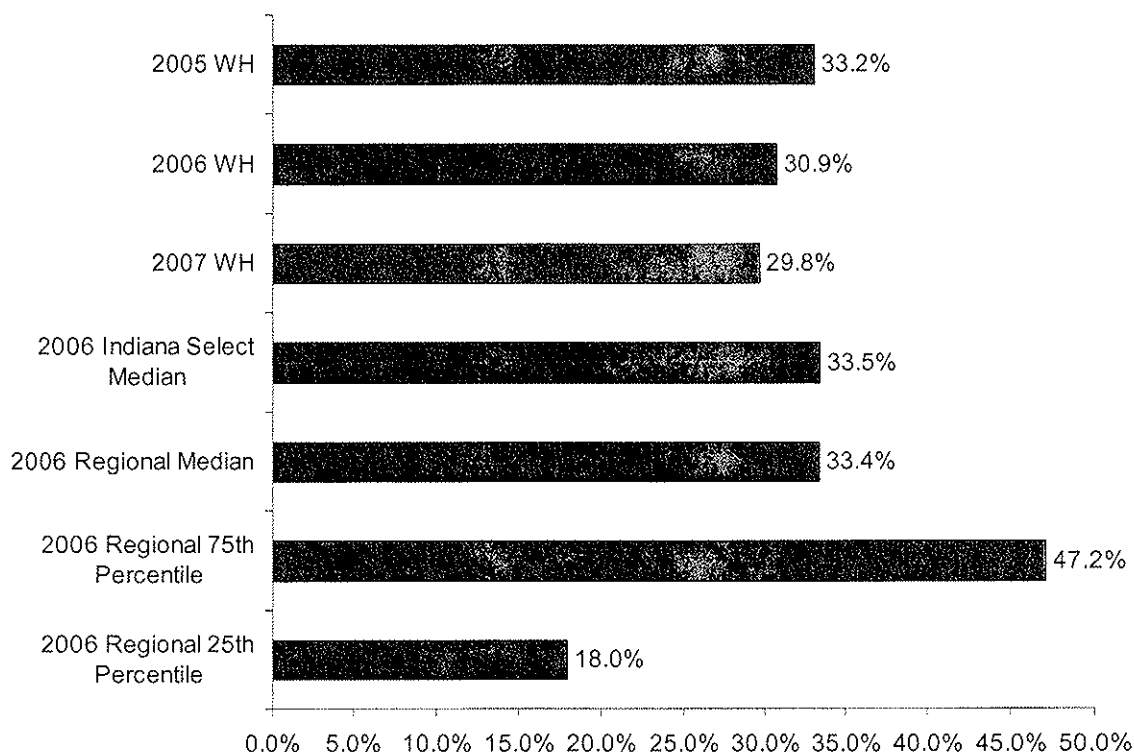
### Performance Implications

A steadily increasing value indicates resources are not being used to renovate the hospital. It may also indicate that significant capital expenditures may be required in the near future. Hospitals with older facilities typically have less debt. However, higher performing hospitals have significantly newer plants than lower performing hospitals.

# Westview Hospital

## Long-Term Debt as a Percentage of Total Capital

CPAS - ADVISORS



Desired Position: Preference

US Trend: Stable

US Forecast: Slight decrease

### Formula

Long-Term Debt / (Long-Term Debt + Net Assets)

### Definition

This is a traditional measure of the extent to which a hospital has relied on debt vs. retained earnings and invested or donated capital. It provides a measure of the ability to carry additional debt.

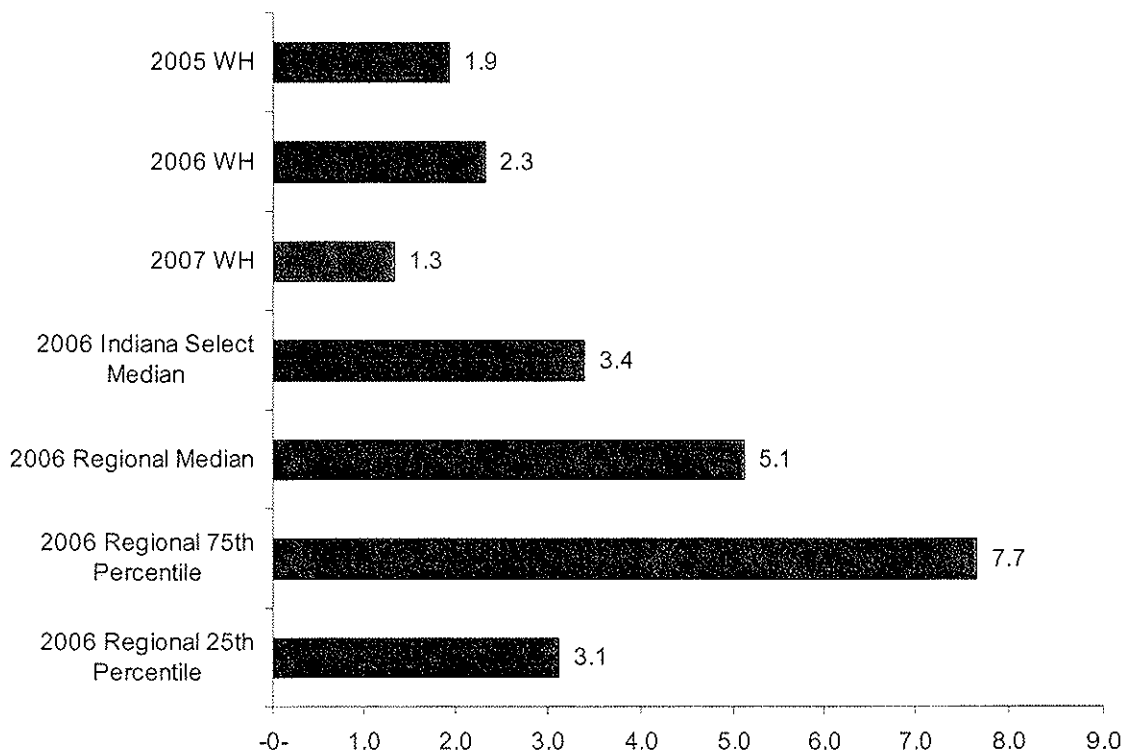
### Performance Implications

Higher values may limit future financing opportunities. Operating expense pressures, contribution declines and decreased investment returns have generally constrained growth in net assets, which have not kept pace with increasing debt.

# Westview Hospital

## Debt Service Coverage

CPAS ADVISORS



Desired Position: High  
US Trend: Slight Decreasing  
US Forecast: Stable

### Formula

$$\frac{(\text{Total Excess of Revenues Over Expenses} + \text{Interest, Depreciation and Amortization})}{(\text{Principal Payments} + \text{Interest Expense})}$$

### Definition

This is a measure of the viability of the Hospital. This ratio reflects the ability to fund annual debt service cash flow from net cash revenues.

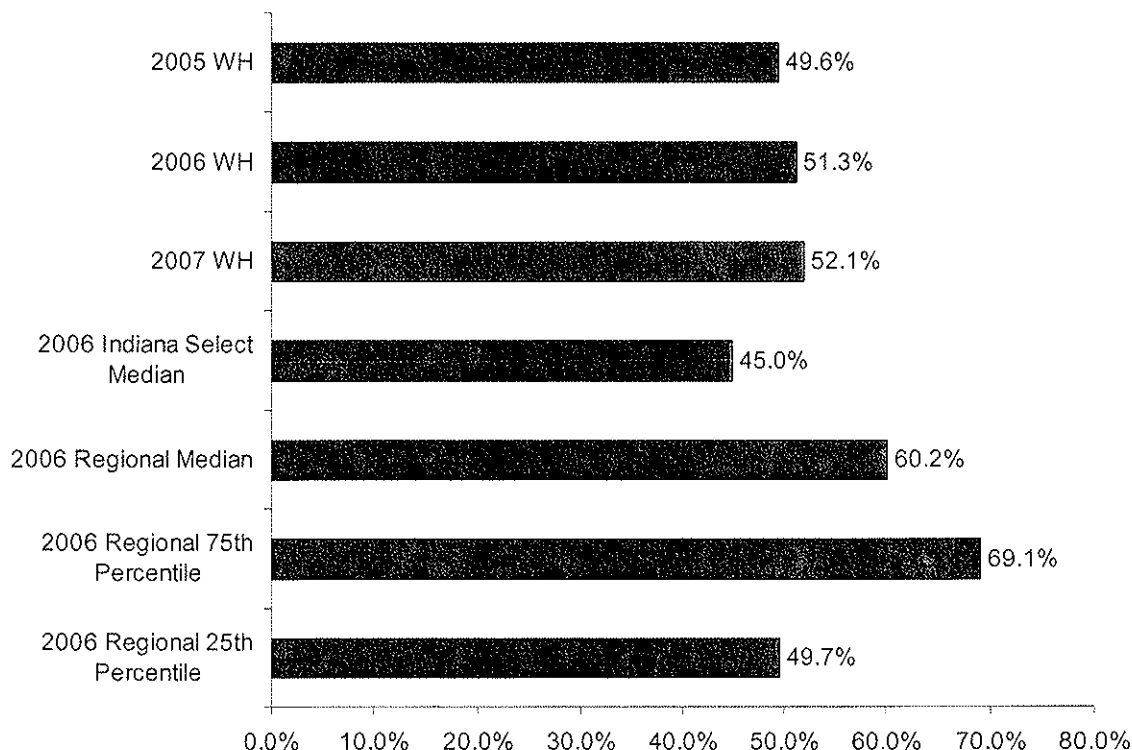
### Performance Implications

Many debt obligations require hospitals to maintain a debt service coverage ratio of at least 1.2 times maximum annual debt service. The ratio has tended to decrease in the past several years due to lower profitability.

# Westview Hospital

## Contractual Allowance Percentage

CPAS / ADVISORS



Desired Position: Low  
US Trend: Increasing significantly  
US Forecast: Increase

### Formula

Contractual Allowances / Gross Patient Service Revenue

### Definition

The percentage of gross patient revenue that is discounted to third-party payors.

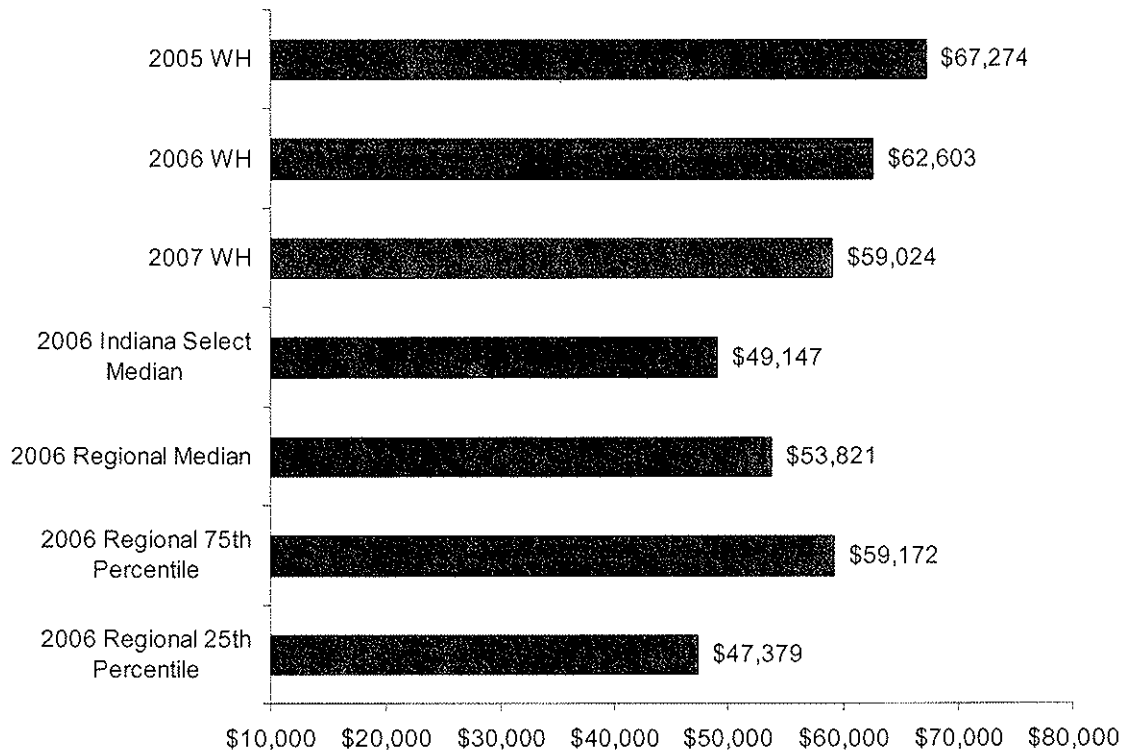
### Performance Implications

High-performance hospitals have similar gross prices on a case mix-adjusted basis compared to low-performance hospitals, however, they have higher net prices. Lower write-offs are either a reflection of a better payer mix, especially private insurance, with lower discounting, or better coding of cases.

# Westview Hospital

## Salary per Full-Time Employee (FTE)

CPAS · ADVISORS



Desired Position: Preference  
US Trend: Increasing  
US Forecast: Inflationary increase

### Formula

Salaries and Wages / Number of Full-Time Employees

### Definition

Measures the relative cost of the largest resource item used in the hospital industry.

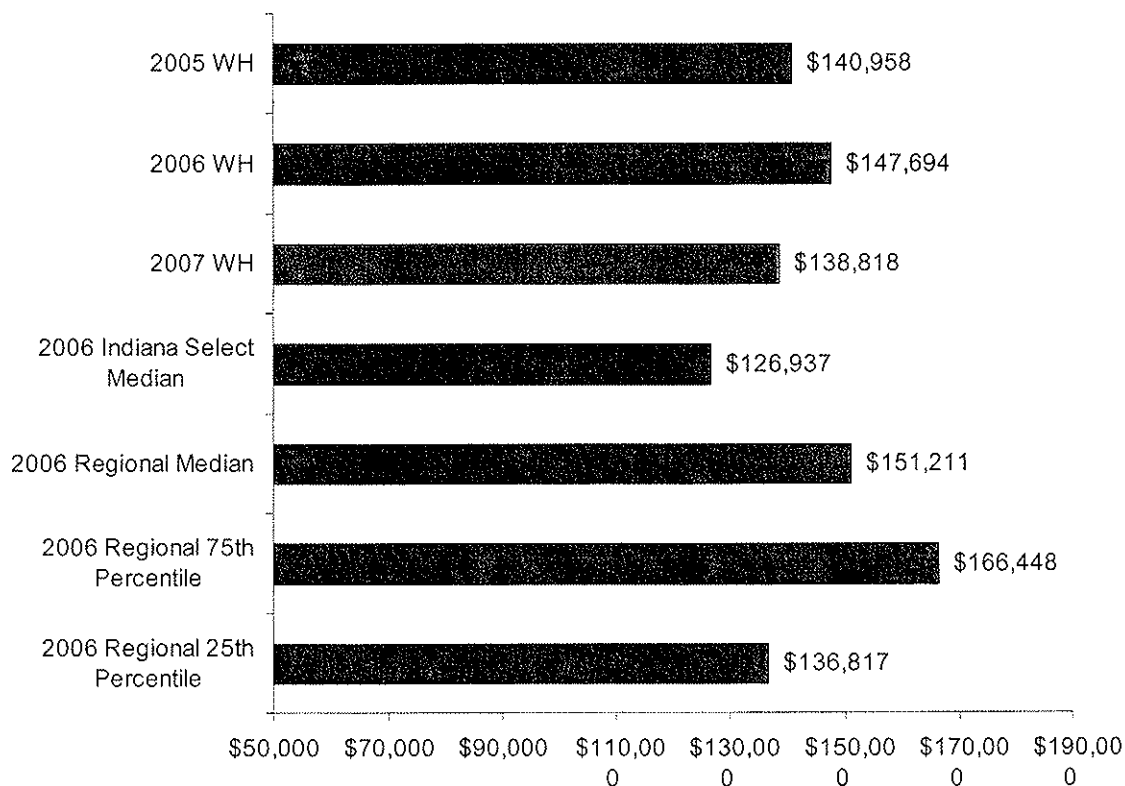
### Performance Implications

High-performance hospitals have higher salary structures when compared to low-performance hospitals. Control over salaries and wages and supply costs is one of the most effective ways to improve profit margins.

# Westview Hospital

## Revenue per Full-Time Employee (FTE)

CPAS · ADVISORS



Desired Position: High  
US Trend: Increasing Sharply  
US Forecast: Increase

### Formula

Total Revenues / Number of Full-Time Employees

### Definition

Measures the productivity to compare performance across different industries.

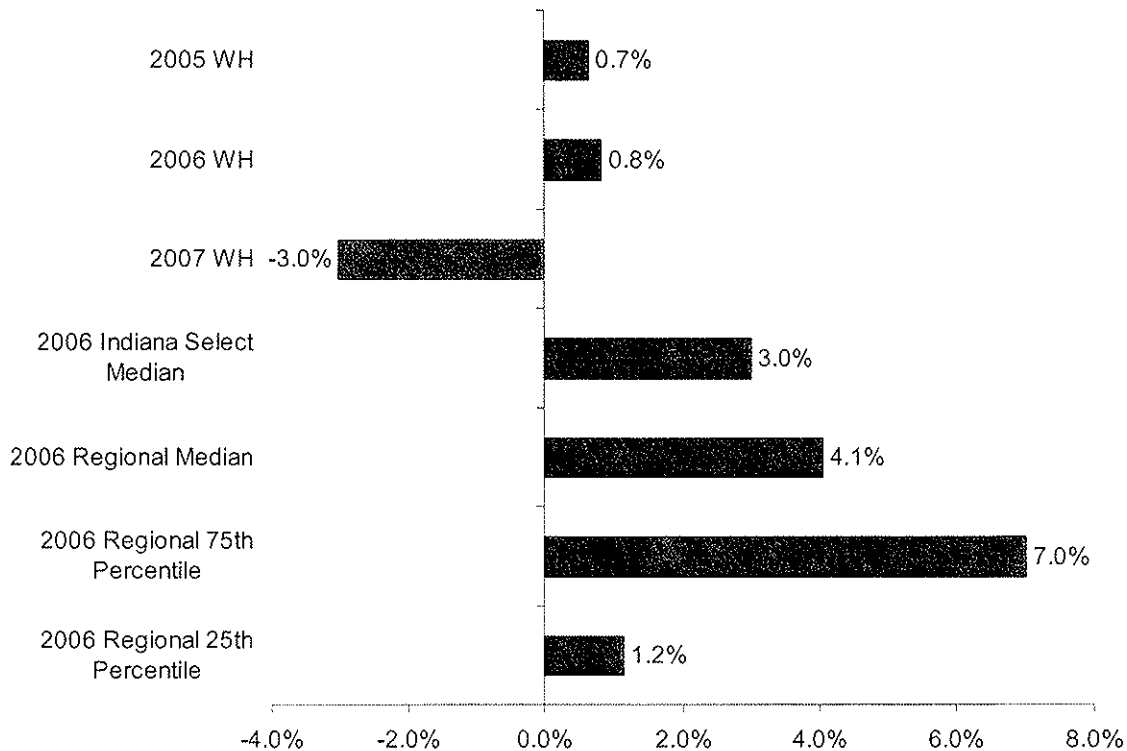
### Performance Implications

High performance hospitals have higher values for Total Revenue Per FTE than low-performance hospitals and the gap appears to be widening. The ultimate measure of productivity is value created per FTE, and high-performance hospitals are doing exceptionally well in this area.

# Westview Hospital

## Operating Margin

CPAS - ADVISORS



Desired Position: High  
US Trend: Fluctuating, Slight Increase  
US Forecast: Fluctuating, Slight Increase

### Formula

Income From Operations / Total Operating Revenue

### Definition

The Operating Margin indicates the amount of return per dollar of operating revenues.

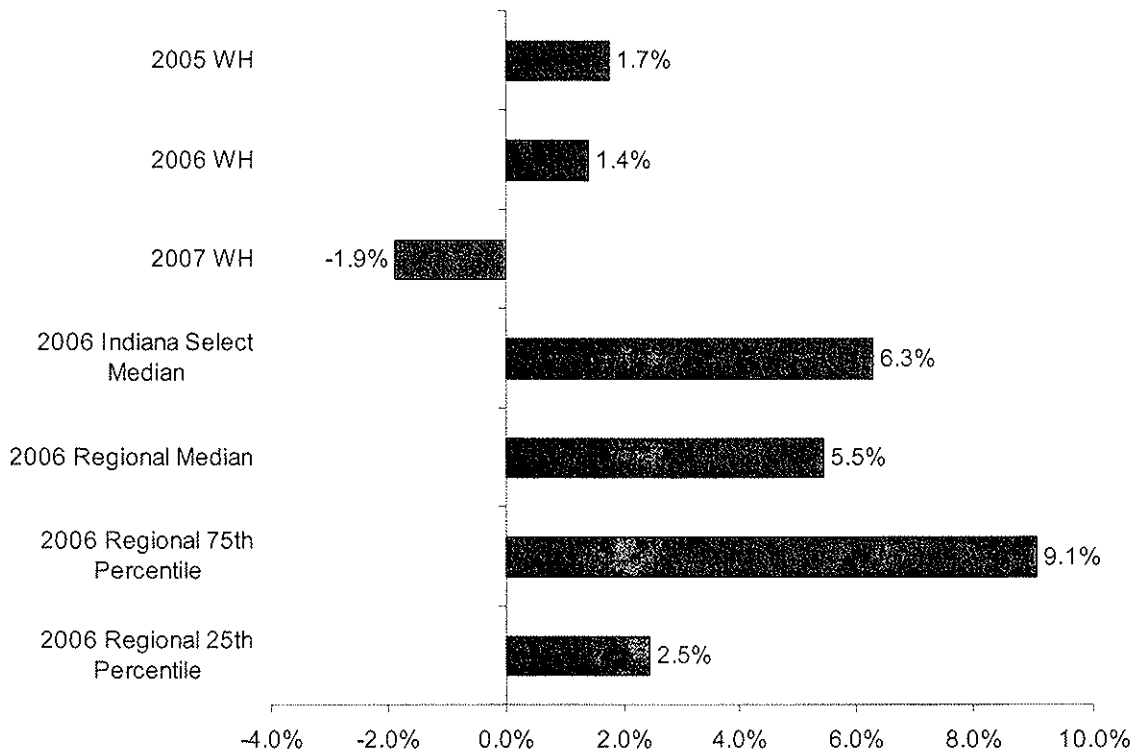
### Performance Implications

This ratio represents the hospitals ability to generate a profit from operations. Improving operating profitability has been the factor contributing most to the increase in total margin for the high-performance hospitals and declines in operating profitability have caused the decline in total margin for the low-performance hospitals. High-performing hospitals have substantial cost and price advantages over low-performing hospitals.

# Westview Hospital

## Total Excess Margin

CPAS · ADVISORS



Desired Position: High  
US Trend: Decreasing  
US Forecast: Stable

### Formula

Total Change in Net Assets / Total Operating and Nonoperating Revenues

### Definition

The Total Excess Margin Ratio indicates the amount of return per dollar of revenue and support and thus the ability to generate profit from both operating and nonoperating activities.

### Performance Implications

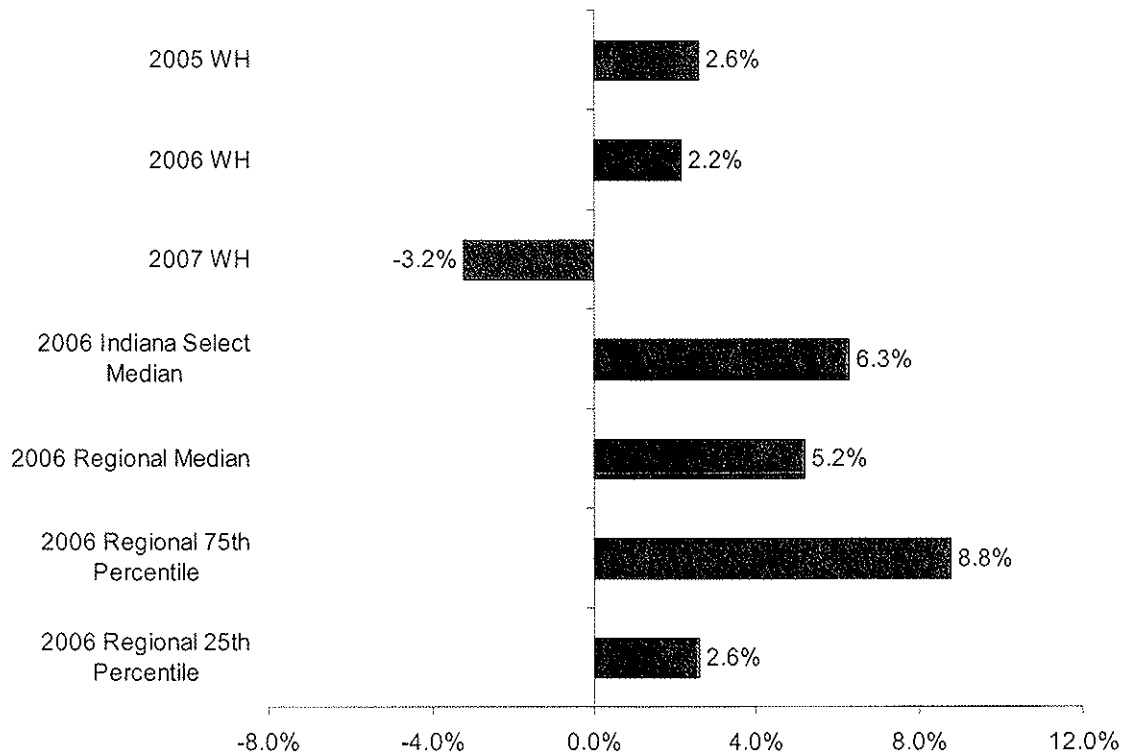
A value greater than zero for the Total Excess Margin ratio is necessary for the Hospital to positively effect net assets, maintain favorable balance sheets and provide adequate reserves for future needs.



# Westview Hospital

## Return on Net Assets

CPAS • ADVISORS



Desired Position: High  
US Trend: Increasing  
US Forecast: Slight decrease

### Formula

Change in Net Assets / Net Assets

### Definition

The Return on Net Assets is a profitability ratio which measures the amount of return per dollar of net assets and thus profitability of net assets invested.

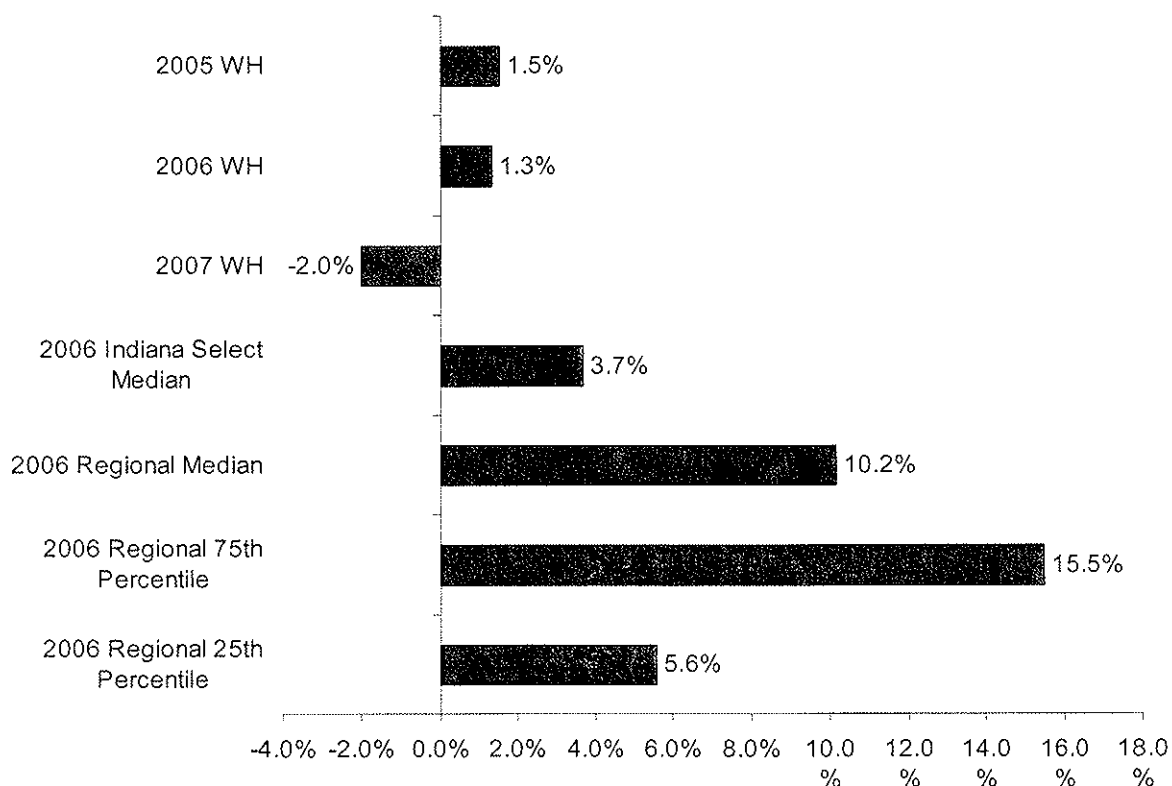
### Performance Implications

Total margins have a significant impact on this ratio as net assets are a smaller base for return ratios. Capital structure and the level of debt can also have an impact on the ratio performance.

# Westview Hospital

## Return on Total Assets

CPAs - ADVISORS



Desired Position: High

US Trend: Stable

US Forecast: Stable Over Next Few Years

### Formula

Change in Net Assets / Total Assets

### Definition

The Return on Total Assets is a profitability ratio which measure the amount of return per dollar of total assets and thus profitability in terms of asset efficiency.

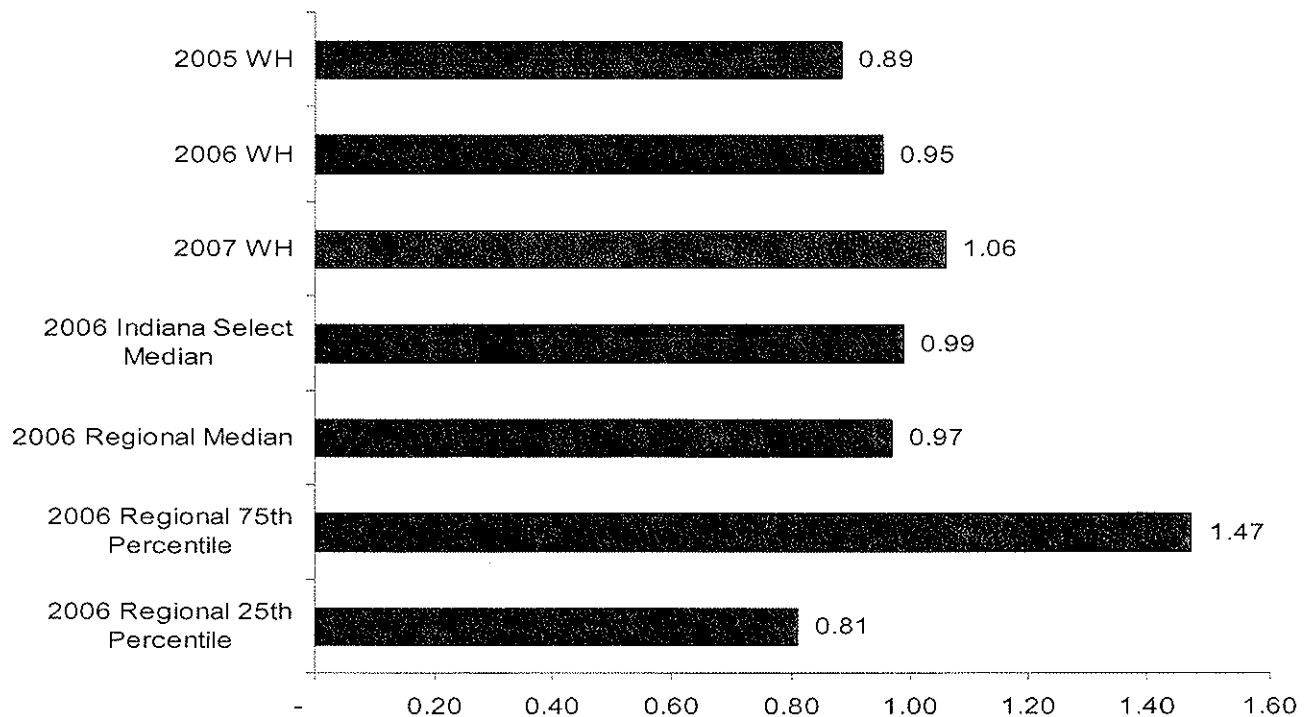
### Performance Implications

Hospitals need to maintain a return on total assets of 3% - 4% in order to replace plant and equipment and keep up with inflation of operating costs. Hospitals with a newer plant and/or a larger asset base are challenged to maintain commensurate profitability with related charges such as higher depreciation and interest. Maximizing non-operating income and increasing asset efficiency both result in higher values for Return on Total Assets.

# Westview Hospital

## Total Asset Turnover

CPAS ADVISORS



Desired Position: High  
US Trend: Stable  
US Forecast: Increase

### Formula

Total Revenue / Total Assets

### Definition

Total asset turnover provides an index of the number of revenue dollars generated per dollar of asset investment.

### Performance Implications

Low performance hospitals tend to have higher asset turnover ratios due to high performance hospitals larger investment balances and newer plant. However it is important to gain efficiency with a ratio approaching 1 to 1 as services continue to migrate to the outpatient setting.





Blue & Co., LLC / One American Square, Suite 2200 / Box 82062 / Indianapolis, IN 46282  
main 317.633.4705 fax 317.633.4889 email blue@blueandco.com

March 6, 2008

Board of Directors  
Westview Hospital and Affiliated Entities  
Indianapolis, Indiana

We have completed our audit of Indianapolis Osteopathic Hospital, Inc. d/b/a Westview Hospital and Affiliated Entities' (the Hospital) combined balance sheet as of August 31, 2007, and the related statements of operations and changes in net assets and cash flows for the year then ended. Our opinion on the combined financial statements is included in the bound copies of the financial statements.

Professional standards require that certain communications be made to the Hospital regarding the audit and other issues underlying the financial statement. Our communication under these standards is as follows:

#### Our Responsibility under Generally Accepted Auditing Standards

As stated in our engagement letter, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud, or other illegal acts may exist and not be detected by us.

As part of our audit, we considered the internal controls of the Hospital. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

#### Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Hospital are described in Note 1 to the financial statements. We noted no transactions entered into by the Hospital during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

### Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Allowance for doubtful accounts for patient accounts receivable
- Contractual allowances for patient accounts receivable
- Estimated third party settlements
- Accrued medical claims
- Pending litigation

We evaluated the key factors and assumptions used by management to develop the estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

### Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Hospital's financial reporting process (that is, cause future financial statements to be materially misstated). The following is a summary of significant audit adjustments for 2007:

	Increase (Decrease) in Net Assets
Contractual allowance	\$ (1,448,213)
Bad debt reserve	(778,096)
Estimated third party settlement	522,701
SHO withhold reimbursement	281,531
Unrealized gain on derivative	57,199
Other adjustments	(128,359)
	<u>\$ (1,493,237)</u>

#### Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Hospital's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

#### Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Hospital's auditors. These discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

#### Difficulties Encountered in Performing the Audit

We encountered significant difficulties in performing and completing our 2007 audit. Financial information was not complete and requested information for the audit was not initially available. This required regular and considerable follow up to obtain and extract the information to complete the audit.

## **RECOMMENDATIONS RELATED TO INTERNAL CONTROL SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES**

In planning and performing our audit of the combined financial statements of the Hospital as of and for the year ended August 31, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the following deficiencies to be significant deficiencies in internal control:

### Property and Equipment Disposals

During our testing we noted that procedures for disposing of property items did not provide adequate approval for the disposal or the proper physical or accounting control over the assets or proceeds from disposition. We recommend that a request for disposal be prepared that describes the asset, the reason for and means of its disposal, and any expected proceeds. This request can then be forwarded to the accounting department for proper recording on the general ledger. We also recommend a threshold be established whereby requiring Board approval of all disposals in excess of an approved dollar amount.



#### Written Policies and Procedures

The Hospital does not have a written or approved accounting policies and procedures manual. Other pertinent policies and procedures related to privacy, information technology, physical and system security, back-up, physical emergency, and disaster recovery plans should be included. Written procedures, instructions, and assignments of duties will prevent or reduce misunderstandings, errors, inefficient or wasted effort, duplicated or omitted procedures, and other situations that can result in inaccurate or untimely accounting records. There is also a need for documented and approved accounting policies and procedures in the accounting area to properly define areas of responsibility.

We recommend that a comprehensive Controller's Manual be formally prepared and approved that clearly defines accounting policies, procedures, and internal controls. The manual should also include written policies and procedures for privacy, information technology, physical and system logical access and security, back-up, emergency, and disaster recovery plans applicable to accounting data and personnel.

#### Reconciliation of Patient AR Reports and Review of Credit Balances

During the audit, the Hospital provided various detailed patient account reports as of August 31, 2007. While the totals of the reports agreed, there was always some classification difference between payors and aging categories. The Hospital was unable to reconcile the differences in the reports. Additionally, credit balances totaling over \$600,000 (700 accounts) were included in the total.

We recommend the Hospital review each patient account receivable report to identify and reconcile differences. Additionally, the credit balance accounts should be reviewed and reconciled on a regular basis to ensure the Hospital is in compliance with the accounts.

#### Lack of Segregation of Duties

The Hospital has limited accounting and information technology (IT) personnel. Thus, limitations exist to properly segregate duties. In accounting, there are many instances in which a single individual has control over multiple or all phases of a transaction (including but not limited to):

- Preparing, posting, and reviewing/approving of journal entries
- Authorizing a transaction, receiving and maintaining custody or record keeping of the asset, account, or adjustment that resulted from the transaction
- Preparing, reviewing, and approving analyses, schedules, calculations, rollforwards, supporting detail, and reports

- Receiving checks (payments on accounting), approving write-offs, depositing cash, reconciling bank statements, etc.
- Uploading, reviewing, or approving time/payroll data, calculations, withholdings, compensation, bonuses, ADP reports, and having custody of pay checks

There are four general categories of duties: authorization, custody, record keeping, and reconciliation. In an ideal environment, different employees perform each of these major functions. Due to the small size of the accounting staff, this may not be feasible. However, controls should be implemented in which no one person has control of two or more of these responsibilities. The more negotiable the asset, the greater the need for proper segregation of duties (for instance, cash, negotiable checks, receivables and write-offs, and inventories).

In information technology, duties are not properly segregated between the system programmer and system administrator. As a result, initiation, processing, and approval of IT activities reside with the IT specialists.

We recommend that management take a more active role to achieve separation of duties, by reviewing the work done by others, strengthening the control structure, and having an independent manager review the accounting and IT department duties on a random basis. For example, an accounting manager could periodically review the monthly closing checklists, exception reports, or system history logs showing activity. In information technology, a manager could periodically review IT activity via exception reports or other applicable reports. Another alternative is to engage an IT consultant to perform a limited review and make any resulting recommendations.

#### User Access to Computer Systems and/or Tasks Not Compatible with Assigned Duties

During the 2007 audit, we noted user accounts that appeared inappropriate, unauthorized, outdated, not compatible with assigned duties, and/or did not demonstrate proper segregation of duties. In addition, the set-up, changes, and deletion of user access is not formally documented, reviewed, and/or approved or performed on a timely basis. Several accounts represented employees who had previously left the Hospital, access may have not been updated to reflect only current assigned duties in a timely manner. In addition, it appeared unnecessary or incompatible access was granted to third party providers, including patient data of a sensitive nature. Unauthorized access to records and patient data is the largest risk, and the lack of formally documented or ineffective existing procedures highlights a larger issue. If duties are incompatible or do not reflect a proper segregation of duties. A regular and timely review of system access has not been adequately or routinely performed or documented by appropriate management. User IDs and passwords were also written and unsecured, appeared shared by users, and were comprised of "dummy", universal, inappropriate, and unidentifiable users.

We recommend that standardized forms or policies and procedures be formally documented and approved by the employee's supervisor for all new user accounts, changes in user access, and deletions for employee terminations. In addition, each user's access assigned to computer systems, modules, screens, etc. should be printed and given to his/her supervisor. Each supervisor should review and sign-off for each user within each assigned area/group. Then, an independent review of proper documentation and approvals of set-up, change, and deletion forms should be performed each month by appropriate IT personnel.

\* \* \* \* \*

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute material weaknesses.

#### Reconciliation of Key Accounts to the General Ledger

During the 2007 audit, numerous journal entries were posted to the final preaudit trial balance. These entries were either presented by management or were identified during the course of the audit. Many of the adjustments related to monthly accruals and reconciliations. Historically, the Hospital had not consistently recorded these adjustments to produce GAAP (Generally Accepted Accounting Principles) basis financial statements.

The Hospital's accounting staff has to gain the ability to measure, post and record these types of entries monthly. We discussed the basis and rationale for the adjustments with management and believe generating and recording the adjustments will not require significant time or effort to implement. We recommend management record the accrual entries and other various reconciliation adjustments on a monthly basis. This will provide a more accurate financial reporting package to management and the Board of Directors to better assess overall financial performance.

#### Timely and Complete Account Reconciliations and Monthly Closing Checklist

During the audit, we noted several key bank accounts were not reconciled to the monthly bank statements completely, accurately, or on a timely basis, and significant differences were not immediately identified and resolved. In addition, a formal and comprehensive monthly closing checklist was not prepared, completed, reviewed, or approved. Thus, reconciliations, analysis of accounts, schedules, journal entries, reports, etc. and a general knowledge of what duties performed each month could not be properly identified, monitored, or approved. There is an overall lack of accurate, complete, or timely performance of most typical month-end closing duties for accounting and lack of proper management oversight.

We recommend that a month-end closing checklist of all account reconciliations, monthly closing of the books, and distribution of reports be formally developed and approved by management. This checklist should include, at a minimum, all tasks and reports, the individual(s) responsible, preparer sign-off, reviewer sign-off, and due dates that includes each balance sheet account, significant revenue and expense items, and the distribution list for documentation prepared to appropriate levels of management. Then, an appropriate supervisor should review each task and documentation prepared and sign-off for proper approval each month. The approval level(s) of upper management should review the checklist and spot check certain transactions or tasks for accuracy and completeness. Finally, individuals assigned should be held accountable for timely and accurate completion of the financial statement reporting processes for which they are responsible. Positive and negative feedback should be incorporated into individual evaluations at least annually. At year-end, the timeline should also be followed in connection with the review and annual audit of financial statements.

#### Monitoring Process for Estimating Net Realizable Value of Accounts Receivable

The Hospital did not follow the contractual and bad debt model during the year to appropriately estimate the net realizable value of patient accounts receivable. As a result, patient accounts receivable was adjusted by approximately \$2,226,000 at year end.

We recommend the Hospital follow the established contractual and bad debt model. Additionally, the model should be updated regularly to reflect changes in data related to collections, payor mixes and aging. This will allow the Hospital to improve the processes related to the valuation of accounts receivable for reporting purposes.

### **OTHER RECOMMENDATIONS**

During the course of our audit, we have developed the following additional recommendations for your consideration.

#### Physical Inventory of Property and Equipment

During our testing of property and equipment, we noted that the Hospital had not conducted a physical inventory of fixed assets in several years. A physical inventory of fixed assets will assist in identifying items that are fully depreciated and/or are no longer in use and have not been retired and deleted from the fixed asset detail. We recommend that the Hospital perform a detailed review, including a physical inventory, of the property accounts and remove any assets which are not in use or are deemed obsolete. In addition we recommend that all property have an identification number assigned and affixed to each asset to aid in the record keeping of fixed assets.

### Protection of Confidential Data and Personal Information

During the 2007 audit, we noted confidential and personal information that was not properly or adequately secured or protected. Proper organizational accountability and privacy management should be enacted and enforced by documented policies, procedures, employee education, enforcement, and ongoing privacy and data protection reviews. For instance, CDs with payroll and demographic data were openly available around the office with no password required for accessing data. File cabinets with confidential data were not locked or monitored by management during the daytime or after hours. In addition, confidential data was not properly kept locked during the daytime or monitored.

Furthermore, system access to patient, confidential financial information, and/or payroll data seemed to be open and easily accessible either through inappropriate or incompatible system access or physical access in the office. Please note that an audit or review of data protection and privacy was not performed, nor was included in the scope of the audit. Random observations were made during the course of the audit; however, no reliance can be placed.

An independent privacy review or consultation has not been performed to ensure sensitive employee, personal, payroll, and patient data is being properly protected and handled in the accounting or information technology departments. In addition, there are no formal policies and procedures containing provisions for data protection and privacy. Finally, business associate agreements covering all third party arrangements were not provided by request for the 2007 audit. Responsibilities and the scope of duties to be performed were not communicated to proper levels of management in a complete or timely manner. Finally, it was noted that there was not an appropriate IT representation on the Board to properly integrate technology solutions to overall strategic direction and proper protection of data and privacy concerns.

We recommend a privacy limited review or consultation be performed by an independent, outside third party. The Hospital should also formally designate an appropriate management member as the "privacy steward", and this person should be independent of information technology and accounting. In addition, independent and periodic "data protection and privacy" audit checks and reviews be completed without prior notice given to personnel. Formal policies and procedures should also be written and approved that address proper protection of data and privacy for data collected, handled, stored, documented, managed, and/or transferred within and outside the Hospital either on an automated, manual, or oral basis and in compliance with applicable laws and procedures. Any violations within the Hospital or outside third party vendors should be enforced by appropriate management.

We also recommend each month that an information technology employee search all networks, system data, and other technical locations for potential confidential, personal, etc. data that is not properly protected or in compliance with applicable privacy and corporate policies and procedures and review all actual, attempted, or unusual system breaches or access. A report should be provided to each area's supervisor or appropriate management, as reasonably feasible, for appropriate follow-up.

Finally, we recommend formal business associate agreements be obtained, approved, and monitored by appropriate management for all third party arrangements at least monthly. Any terms, agreements, and potential breaches should be immediately pursued and enforced by appropriate management.

#### Payroll Approval

Department managers currently approve payroll hours before they are submitted to the payroll department for processing. We recommend that a management level individual, independent of the payroll function, review each payroll summary for any unusual items. In addition, another individual independent of the payroll function should be placed in charge of distribution of payroll checks. Such changes will help strengthen the controls surrounding the payroll function.

#### Cash Disbursements

Under current procedures, signed disbursement checks are customarily mailed by the clerk who prints the signed checks. Control over disbursements would be improved if all disbursement checks were transmitted directly to an individual independent of the check preparation process for mailing.

In addition, to help improve the controls surrounding the check preparation process, we recommend the individual responsible for check preparation not have direct access to the electronic check signature card.

#### Debt Covenants

Financial covenants should be monitored on an ongoing basis as a means of avoiding possible violations and resolving any violations on a timely basis. To monitor the covenants, we recommend that a permanent schedule of negative and affirmative covenants of each loan agreement be maintained and monitored by the accounting department. Debt covenants should be monitored on a monthly basis. If a covenant has not been complied with, the noncompliance should be addressed by management and discussed with the lender, and an explanation of the action taken should be attached to the schedule.

Employee Conflict of Interest Policy

The Hospital does not require employees to sign a formal conflict-of-interest policy. We believe that it is in the Hospital's best interests to establish a formal, written policy covering unethical conduct or transactions and relationships that may involve potential conflicts of interest. The policy should provide for an annual statement from management and employees in sensitive positions certifying their compliance with the policy. These statements should be reviewed by management and the Board of Directors.

\* \* \* \* \*

These recommendations are presented for your review and consideration only. Like all other significant business judgments, they must be considered in light of existing procedures and controls present at the Hospital and should be subjected to the usual cost-benefit tests. This communication is intended solely for the information and use by management and the Board of Directors and should not be used by anyone other than these specified parties.

If there are any questions on matters covered in this letter or any other matters relating to our audit, we would be glad to meet with you at your convenience to discuss your concerns.

Once again, we thank you for the cooperation and hospitality we received during our audit.

Sincerely,

*Blue & Co., LLC*

